THE LATEST WORD
March 2004

Official IPERS Information ◆ Retain For Your Records
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Wage Manipulation Costs You!

IPERS' compliance officers have discovered in conducting reviews of employers that the vast majority comply with IPERS' legal requirements and perform their IPERS duties in an ethical manner. Due to the fact that public employers and employees have been greatly impacted by several years of recession, declining revenues, and increasing costs, it can be tempting for employees to want to inflate their retirement benefits and for employers to shift costs to the retirement system. The purpose of this article is to begin an important discussion on an issue that is becoming increasingly divisive in recent years--manipulation of wages resulting in spiking of benefits.

To ensure the financial stability of our retirement system, our actuary makes certain assumptions about demographics and behavior. While the actuarial model used to make projections is very complex, the actions that result in spiking of benefits above the level that is expected can often be observed because there is a change in the normal progression of wages.

An important factor in computing IPERS' retirement benefits is the average of the three highest calendar years of covered wages (Final Average Salary or FAS). Any action that increases the rate of increase in salary above the assumptions used in the actuarial model will cost the system because it has not been factored into the projections. In order to increase the FAS above the normal progression, some employers may pay employees in a manner that results in moving future earnings into the FAS period, convert certain benefits to cash only for the last three years, provide bonuses, or increase wages above the normal level in contemplation of retirement.

Most individuals and employers involved in these strategies probably believe that they are only engaging in good retirement planning because they are paying the contributions on the increased compensation from the time it is paid. What is forgotten is the actuarial assumption that contributions must be paid for several years on

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Special Class Rates Effective July 1, 2004

As part of IPERS' annual actuarial valuation of the previous fiscal year, the following special class contributions rates will be effective July 1, 2004. IPERS' regular class rates can only be changed by legislative amendment; therefore, until notified otherwise, regular class rates will remain unchanged.

	Employer	Member	Total
Sheriff/Deputy Sheriff/Airport Firefighter	7.66	5.10	12.76%
Protection Occupation	9.23	6.16	15.39%

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increases in compensation to pay for the corresponding benefit. This means that contributions on spiked compensation are not paying for the full actuarial cost of increased benefits. Part of the obligation will have to be paid for from current resources of the system or added to unfunded liabilities.

Under these type of circumstances, employers may believe that they are only helping an employee get a better retirement benefit, and employees may feel that they are entitled to a higher benefit because of their years of dedicated service. Of course, the model allows for some variations from the assumptions, but when the covered wage increases exceed the average step and wage COLA increases in the highest three years, there is cause for concern. The following example illustrates this point.

John Doe, an employee with 26 years of service, informed his employer on January 1, 2002 that he would retire December 31, 2003. His employer, pleased with John's performance and wanting to ensure that he will receive the highest retirement benefit, decides to give him a $25,000 bonus. John was earning $50,000 with his latest raise and had been averaging wage increases of about 5 percent per year (not far from the actuarial assumption for his age). Since both John and the employer paid IPERS contributions on the bonus, they believed they had paid for the additional benefit. To test this idea, the table below compares the benefit with the average increase to the one including the bonus.

The effect of the employer giving a $25,000 bonus in the final year of employment results in the benefit increasing from $2,065.17 to $2,426.25 per month, a jump of over $361 per month for the rest of John Doe's life. It should be clear that the additional contributions of $2,362.50 from the bonus would be able to pay for only the first six months of the increase in the benefit. (This does not even consider the long range actuarial liabilities.) Of course, this is an extreme case, but any increase in salary above the actuary's assumed rate may adversely impact the system.

Scenario 1:	**No Bonus**		
Year	***Covered Wages***	***FAS***	***Benefit (Option 2)***
2003	$50,000	Sum ÷ 3	Yrs/30 x FAS x 60%
2002	$47,619	$142,970 ÷ 3	26/30 x 47,657 x 60%
2001	$45,351		
	Sum = $142,970	FAS = $47,657	**Benefit** = $24,782 (Annually)

Scenario 2:	**$25,000 Bonus**		
Year	***Covered Wages***	***FAS***	***Benefit (Option 2)***
2003	$75,000	Sum ÷ 3	Yrs/30 x FAS x 60%
2002	$47,619	$167,970 ÷ 3	26/30 x $55,990 x 60%
2001	$45,351		
	Sum = $167,970	FAS = $55,990	**Benefit** = $29,115 (Annually)

Difference	$25,000 or 17½%	$8,333	**$4,333 or 17½%**

While the model projects different average increases in covered wages for different age groups, we have not yet determined an absolute rate of increase that is automatically considered excessive. There are many more factors that can be considered in determining what “excessive” means, but simply being reasonable may head off the need for more stringent legal requirements.

Even though the IPERS trust fund is over $17 billion, retirement benefits for hundreds of thousands of retirees must be paid for long into the future. If our financial experience continues to vary significantly from our assumptions, the system may have to raise contribution rates above the current proposed increases or may even have to cut future benefit accruals to maintain financial solvency.

If members and employers don’t police themselves on this issue, IPERS may be forced to pursue tough new restrictions that limit spiking. That may have the unintended consequence of affecting those who have done no spiking but who may somehow fall within the restrictions (situations caused by breaks in service, moving from part-time to full-time status, promotions, etc).

Since IPERS is facing a long-term unfunded actuarial liability problem, we will be conducting queries and doing research on new retirees’ accounts to determine if there is evidence of spiking. While there are no simple answers to this problem, we need to continue the dialog and research on fairness, equity, and financial responsibility and take prudent actions to stop or limit practices that are not fair and/or that have adverse effects on unfunded actuarial liability. We welcome your thoughts, ideas, and suggestions on this issue and respectfully request your cooperation in preventing problems wherever possible. If you have questions or concerns, you may contact Curt Sorteberg by e-mail at curt.sorteberg@ipers.org or by calling 1-800-622-3849 or 515-281-3313.

Submittal of Magnetic Reel Tapes

IPERS will be removing our old technology magnetic reel-to-reel tape drive (IBM 9348), as very few employers submit wages or other data with this style of tape. IPERS now uses the IBM 3490 and IBM 3590 tape drives and will only accept the compatible 3490/3590 magnetic tape cartridges as of May 31, 2004.

If any employers are still submitting data on reel tape, other arrangements will need to be made before the May 31, 2004 deadline. IPERS highly recommends utilizing the new Internet based ICON wage reporting system in which data can be submitted directly on the Web site or by electronic submission using FTP (file transfer protocol). If the ICON method is not feasible, third party vendors will be able to convert magnetic reel tape to magnetic cartridges for a fee.

If employers are still submitting wage reports on 3.5 inch floppy diskettes, we also strongly encourage use of the ICON system instead of mailing floppy disks. This will speed the reporting and prevent the possible transmission of viruses and other malevolent software.

2004 Wage Ceiling

Effective January 1, 2004, the Internal Revenue Code limitation that applies to IPERS covered wages increased from $200,000 to $205,000. Wages paid to employees above this limit should not be reported for IPERS purposes. Please make the appropriate changes to your payroll for calendar year 2004.

Old Paper Forms

IPERS has instituted an electronic document system which provides staff the ability to view electronic images of documents. Due to the implementation of this system and the future implementation of electronic forms and workflow routing, it is becoming essential for employers to submit current forms instead of using stockpiled forms or photocopies of old forms.

Please destroy old forms. This will prevent possible time delays and requests for additional information.

Forms are available on the IPERS Web site (http://www.ipers.org/forms.htm) which can be printed, completed, signed, and mailed to IPERS. All forms on the IPERS site are current and meet legal requirements.

Check Us Out

Employers who visit our Web site at www.ipers.org and select the green tab can view their very own home page featuring online publications, forms, answers to frequently asked questions and, of course, ICON (IPERS Connection Online).

Want to know what ICON can do for you? Select the link "Sneak Preview" in the ICON paragraph. Want to be an ICON user? Select "How To Enroll" located in the ICON paragraph. You will find the three easy steps. Call the IPERS Accounting or Employer Relations Team for information or assistance with using IPERS' Web site.

Enrolling New Employees in IPERS Through the ICON System

An efficient and easy way to enroll your new employees is to use the ICON System on our Web site at www.ipers.org under the green "Employers" tab. To become an ICON user, see "How to Enroll" located in the ICON paragraph.

A completed "IPERS Membership Information and Beneficiary Designation" form must still be submitted to IPERS.

IPERS Work Group to Research Section 125 Plans

IPERS' compliance officers have discovered several cases involving the incorrect application of the IPERS coverage rules for the employer contributions provided under IRC section 125 plan arrangements (often referred to as "cafeteria plans"). The errors are generating an increasing number of requests for wage adjustments following compliance reviews. Additionally, IPERS is also seeing an increasing number of federal compliance reviews and severe penalties by the IRS.

Many compliance reviews for employers with Section 125 plans reveal a very informal, ad hoc approach to Section 125 Plan administration and the IRC and IPERS requirements. While IPERS has adopted its own administrative rules that describe the application of the IPERS coverage rules in some detail, these rules cannot be effectively implemented without better documentation of the amounts and availability of employer contributions. Furthermore, there appears to be a need to examine the impact of IPERS coverage rules across different IPERS employers, to benchmark other systems in terms of best practices, and to reassess continued IPERS coverage for these amounts.

CEO Donna Mueller, in cooperation with the Benefits Advisory Committee, is establishing a work group of IPERS staff and employer representatives to research this issue and to make recommendations on possible solutions to the coverage issues that have been encountered. Compliance Officer Danielle Huffine will coordinate the activities of the work group, and she will be contacting employer groups on representation and cafeteria plan content. The work group welcomes your input on issues related to coverage of cafeteria plans, especially as it relates to uniformity and equity for various groups. There will be more information on this activity in future issues of this newsletter.

Employer Satisfaction Survey Results

We want to thank those of you who completed the employer satisfaction survey. Preliminary results indicate that you are basically satisfied with *The Latest Word*, but as in most cases, there is still room for improvement. The results up to the current time are summarized in the table below (5 is very satisfied, and 1 is very dissatisfied).

While we are pleased that over 90 percent of the survey participants rated the newsletter "4" or above for all categories, there were enough "4" and lower ratings to indicate that we can do better. Good comments were also received and were summarized.

As we announced in the September 2003 issue of *The Latest Word*, information that involves significant policy changes or legal requirements that affect employers will be published in numbered bulletins. This method will make it easier for employers to track and retrieve important IPERS information. This newsletter will focus on dialog and involvement of employers in issues of mutual concern.

We welcome your input on issues for which you need additional information, sharing of information that you believe will be of use to other employers, feedback on articles included in the newsletter, and other ideas for articles. You may send us your ideas as "Letters to the Editor," telephone calls to the Employer Relations staff, or e-mail notes to employerrelations@ipers.org.

	1	2	3	4	5
Overall Satisfaction	1.0%	0.5%	4.6%	34.2%	59.7%
Content	1.0%	0.5%	4.1%	33.7%	60.7%
Appearance	1.5%	0.5%	4.6%	28.6%	64.8%

Legislative Update

IPERS currently has one piece of legislation making its way through the legislative process in both chambers. In our attempt to keep all members apprised of legislation that may affect them, the following provides a brief overview of what has been proposed.

Senate File (SF) 2078 addresses changes to IPERS, the Peace Officers Retirement System (PORS), and the Municipal Fire and Police Retirement System (MFPRS). Some of the major changes in this bill address "vesting" by age vs. years of service; elimination of wage manipulation (see article on page 1 of this newsletter); retroactive payments; mandatory lump sum distributions to inactive members and beneficiaries of inactive accounts; and clarification of service purchases. This bill is eligible for debate in the Senate.

Minor changes to the bill discuss clarification of quarters of service during unpaid leaves of absence; electronic deposits of pension payments; clarification of nonvested inactive members' beneficiaries; and the administration of service purchases.

As of this writing, the House companion bill (HSB 574) had not yet been assigned a HF number, but it has been voted out of the State Government Committee for consideration by the full House. It includes a provision extending helpful options for employees who experience reduction in hours or other pay actions reducing their salary.

Another legislative proposal that will potentially be addressed this year involves changes to IPERS contributions made by both employers and employees and the calculation of final average salary and early retirement adjustments. If passed, Iowa Code section 97B.11 will be amended to increase, over a four-year period beginning July 1, 2005, contributions to the system from the employer and employee. These proposals were made by IPERS and the Benefits Advisory Committee and endorsed by the Governor.

Currently for regular employees, the employer rate is 5.75 percent and the employee rate is 3.7 percent of a member's covered wages. This bill would increase the employer rate by .6 percent each fiscal year beginning July 1, 2005, until the rate reaches 8.15 percent beginning July 1, 2008. The employee percentage would increase by .4 percent each fiscal year beginning July 1, 2005, until the rate reaches 5.3 percent beginning July 1, 2008.

These are important issues facing IPERS. We look forward to keeping our members informed as these bills continue through the legislative process. You can access IPERS' Web site at www.ipers.org so you can track the legislation.

FYI

A published copy of IPERS' Comprehensive Annual Financial Report for the fiscal year ended June 30, 2003 is enclosed with this mailing.

For your convenience, our Web site at http://www.ipers.org/publications.htm offers a PDF version of this report.

NEW REPORTING OFFICIAL TRAINING

- This training session is offered semiannually and is designed to assist new reporting officials, who are accountable for IPERS reporting, in understanding their responsibilities. There is no charge for this training. Sessions will be held at IPERS, 7401 Register Drive, Des Moines.
- This training session includes basic information on topics such as temporary employment, optional coverage, coverage of wages and benefits, and reporting forms and procedures. **Please note: We will likely be unable to provide information on pending legislation in our April training session. Such information, if any, will be provided during our annual June training.**
- Please complete and return the attached registration to IPERS at the location on the bottom of the registration. Remember to indicate the day you wish to attend.
- Registrations are due by April 6, 2004. Return your registration early for best availability.
- After IPERS has processed your registration, you will receive a confirmation by mail or email with detailed location information.
- Training materials will be distributed the day of the session.
- Due to logistics and because there is no fee for this training, we are unable to provide refreshments. There are vending machines available at IPERS, but feel free to bring your own refreshments.
- Questions? Call IPERS at 800/622-3849 and ask for Melinda, Pat, Danielle, or Linda.

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Employer ____IPERS Employer ID ________________

Address ____

City ____State ________ Zip __________________

Email Address ____

Attendee____ Daytime Phone _________________________

Please indicate 1st and 2nd choice, if applicable.

_____ Tuesday, April 20, 2004 1:00 pm – 4:00 pm

_____ Wednesday, April 21, 2004 9:00 am – 12:00 pm

_____ Wednesday, April 21, 2004 1:00 pm – 4:00 pm

RETURN TO:

IPERS Employer Relations Team • PO Box 9117 • Des Moines, IA 50306-9117
Fax number: 515/281-0053